

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Wholesale Rates of Public Utility	)	
Sellers of Energy and Ancillary Services in the	)	DOCKET NO. EL01-68-000
Western Systems Coordinating Council	)	
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**COMMENTS OF THE WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION**

Under Section 206 of the Federal Power Act (16 U.S.C § 824e), the Federal Energy Regulatory Commission (“Commission”) is conducting an investigation into the rates, terms, and conditions of public utility sales for resale of electric energy in the Western Systems Coordinating Council (“WSCC”), excluding sales through the California ISO markets. The Commission has limited its investigation to sales that involve electric energy sold in real-time spot markets and that occur when contingency reserves for any control area fall below 7 percent. *Order Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale Electric Markets and Establishing an Investigation of Public Utility Rates in Wholesale Western Energy Markets* (“Order”), 95 FERC ¶ 61,115 at 29 (April 26, 2001).

The Commission has solicited comments on proposed WSCC price mitigation measures in this West-Wide 206 Investigation. Order at 30. The comments of the Washington Utilities and Transportation Commission (“WUTC”) are detailed below. In general, the WUTC recommends that the Commission expand the application of price mitigation measures to cover wholesale transactions at all times, rather than just when contingency reserves fall below 7

percent in any control area.<sup>1</sup> We also suggest specific mechanisms by which price mitigation can be implemented in the WSCC. Acceptance of our proposals will allow the Commission to establish just and reasonable rates in the WSCC, consistent with the Commission's mandate under Section 206 of the Federal Power Act.

## **I. NAME AND IDENTITY OF COMMENTER**

1. The name and address of the commenter:

Washington Utilities and Transportation Commission  
1300 S Evergreen Park Drive SW  
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Olympia, WA 98504-7250

2. All correspondence, communications, and pleadings in this proceeding should be sent to each of the following:

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## **II. INTEREST OF THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

3. The Washington Utilities and Transportation Commission ("WUTC") is an interested commission of the State of Washington, having jurisdiction to regulate the rates and

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<sup>1</sup>The WUTC does not at this time recommend expansion of price mitigation beyond real-time spot markets. This limitation, however, may require further review should price mitigation in real-time spot markets not have beneficial impacts on prices in longer-term electric energy markets.

charges for the sale of electricity to consumers within the State of Washington. The WUTC regulates the retail rates and charges of Puget Sound Energy, Avista Corporation, and PacifiCorp, all of which also buy and sell electric energy at wholesale in the WSCC subject to regulation by the Commission as public utilities.

4. Pursuant to Revised Code of Washington 80.01.075, the WUTC has authority to intervene before the Commission in proceedings in which there is at issue the rates or practices of utility service affecting the interests of the State of Washington, its businesses, and the general public. The West-Wide 206 Investigation is such a proceeding.

### **III. RATES FOR CERTAIN WHOLESALE SALES OF ELECTRICITY IN THE WSCC ARE UNJUST AND UNREASONABLE AND THE COMMISSION'S INVESTIGATION IS WARRANTED**

5. The Commission instituted the West-Wide 206 Investigation because it believes that the rates, terms, and conditions of service for certain wholesale sales of electric energy in the WSCC may not be just and reasonable under current market rules and certain conditions and, thus, should be modified. Order at 29. If the Commission intended to be circumspect in this statement, the WUTC believes such caution is not necessary under the circumstances.

6. Wholesale power costs in the WSCC *are*, at this point in time, clearly unjust and unreasonable and must be modified by the Commission as required by Section 206 of the Federal Power Act. Beginning in June 2000, wholesale power prices in the Pacific Northwest—particularly for day-ahead transactions reported by Dow Jones at the mid-Columbia and California-Oregon border trading hubs—have been unprecedented, and extraordinarily high and volatile. During some periods of time, prices have exceeded \$3000/MWH, more than 100 times the price at which these transactions were made during the previous year. Since December 2000, prices reported by Dow Jones have *averaged* \$300/MWH—more than 10 times the average for

the same months during the preceding year. (*Attachment A.*) These prices are far in excess of the incremental and fixed costs of power generation in the region. Analysis performed by the Northwest Power Planning Council demonstrates that, to recover operating and fixed costs as well as a reasonable return on invested capital, a new combined-cycle power plant would need to anticipate revenues of \$65/MWH.<sup>2</sup> Average prices for wholesale power since mid-2000 consistently have exceeded that level by more than 400%. These unprecedented and volatile prices are causing serious damage to consumers, utilities, and the economy of Washington state.<sup>3</sup> In addition, they undermine the market certainty and stability conducive to attracting the financing necessary for utilities and other parties to build critically needed new generating capacity.

7. The Commission, therefore, was correct to initiate this investigation and we appreciate the opportunity to provide comments at its inception. The WUTC intends to participate in any additional process established in this investigation, but we urge the Commission to act expeditiously given current dire market conditions. We are providing herein our initial comments.

#### **IV. COMMENTS OF THE WUTC**

8. At this stage in this proceeding, our comments are directed at: (1) the circumstances under which price mitigation should be applied in the WSCC; and (2) the specifics of price mitigation measures to be applied in the WSCC.

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<sup>2</sup>*Study of Western Power Market Prices. Summer 2000*, Northwest Power Planning Council, Document Number 2000-18, October 2000, pp. 35-6.

<sup>3</sup>For example, Seattle City Light, Tacoma Power and Snohomish Public Utility District and others, have significantly increased their rates to consumers as a result of high wholesale electric energy prices. Ratepayers of investor-owned utilities in Washington state also face the potential for higher rates to the extent those utilities must purchase electricity in wholesale markets to serve native load. Significant businesses, such as Boeing and Georgia-Pacific, whose rates have been tied to market-based indices, have already suffered the consequences of high wholesale power prices.

**A. When Price Mitigation Should Apply**

9. With respect to the scope of the investigation, the Commission's Order states:

Under section 206 of the FPA, the Commission is instituting an investigation into the rates, terms and conditions of public utility sales for resale of electric energy in interstate commerce in the WSCC other than sales through the California ISO markets, to the extent that such sales for resale involve: (1) electric energy sold in real-time spot markets (i.e., up to 24 hours in advance); and (2) take place during conditions when contingency reserves (as defined by the WSCC) for any control area fall below 7 percent. Order at 29.

10. Limiting the scope of the investigation to periods of time when a control area within the WSCC is unable to meet its required reserve margin ignores the fact that wholesale prices at the WSCC trading hubs have been high and volatile regardless of whether any WSCC control area is in violation of required reserve margins. The 7 percent reserve condition that limits the scope of the investigation appears to be arbitrary and does not take into consideration differences in the regional operation of the Western Interconnection. If market participants are able to exercise market power (and thus to charge rates that are unjust and unreasonable) during times when contingency reserves are at 6.8 percent, they are equally likely to be able to exercise market power during times when contingency reserves are at 7.2 percent. To our knowledge, the only control area in the WSCC to have declared supply emergencies over the past year as a result of failing to meet reserve margins is the California ISO. Prices have been at extraordinarily exorbitant levels throughout the WSCC for both peak and off-peak times, even during periods when the California ISO was not in a declared emergency. Since reserve margin emergencies have not occurred outside the California ISO, but high prices have persisted through the WSCC, there is no reason to limit price mitigation measures only to shortfalls in reserve margin in control areas outside California. Therefore, we believe the Commission should broaden the

scope of the investigation and the application of appropriate price mitigation to all time periods, not just to periods of reserve margin emergency.

11. In addition, application of the reserve margin criterion to the WSCC outside of California is difficult if not impossible. The Order sets the defining condition to be “when contingency reserves (as defined by the WSCC) for any control area fall below 7 percent.” Order at 29. It is unclear how this threshold would be applied in practice across the WSCC. We see several possibilities: (1) the threshold would be applied to *the entire WSCC* whenever *the entire WSCC* is below 7 percent; (2) the threshold would be applied to *the entire WSCC* whenever *a single control area* is below 7 percent; (3) the threshold would be applied to *an entire reserve area* (e.g., Northwest Power Pool, Rocky Mountain Power Area) whenever *the entire reserve area* is below 7 percent; (4) the threshold would be applied to *an entire reserve area* whenever *a single control area* is below 7 percent; or (5) the threshold would be applied only to *a single control area* when that control area is below 7 percent. If the 7 percent threshold is ultimately to become the basis for price mitigation throughout the WSCC, the Commission will need to clarify its application.

12. Moreover, due to the following technical problems, we believe that none of these approaches will prove to be workable:

(1) Reserve-sharing areas like the Northwest Power Pool meet WSCC contingency reserve criteria on a collective basis. On any given day, some control areas within the Power Pool area carry less than 7 percent of what their individual requirements could be, and some carry more. Thus, control areas routinely carry reserves that are below the 7 percent threshold, in accordance with WSCC criteria.

(2) Application of the 7 percent criterion to a hydroelectric-based system is not meaningful. Hydro-based systems have enormous amounts of capacity to meet peak system needs, even at times when low reservoirs cause sustained energy production to be far below normal. This means that actual reserves that a large hydro-based system can call on during a contingency will never be below 7 percent except during a dire emergency.

(3) If the 7 percent criterion is applied to an area smaller than the entire WSCC, an area that declares a Stage 1 emergency may have difficulty acquiring power at exactly its time of greatest need because sellers would be free to sell at unmitigated prices in neighboring areas.

(4) The most difficult problem with applying the 7 percent criterion for mitigation conditions to the WSCC, as it is applied to the California ISO, is that it would require some centralized organization to receive and verify both generation reserve information from utilities, and to receive and verify confidential generator cost data from which to calculate clearing prices. Currently, no entity is in a good position to do this outside of the California ISO. We see the following two types of candidates, both of which are far from ideal:

(a) Control area operators are typically generation owners with load-serving obligations. Control area operators are thus market participants with a strong financial interest in market outcomes. Entrusting control area operators with reviewing confidential cost information from potential competitors and triggering price mitigation through declarations of Stage 1 events is inconsistent with a competitive market.

(b) Regional entities such as the Northwest Power Pool, the security coordinators, or the WSCC receive utility reserve information on a voluntary basis and are not in a position to verify its accuracy. Moreover, their traditional role has been to ensure system reliability. Putting them in the position of declaring emergency events that have enormous market implications could irrevocably jeopardize this extremely important role.

13. The Commission is, then, faced with the choice of either granting control area operators quasi-regulatory authority over their competitors, or placing in jeopardy the role of voluntary organizations entrusted with ensuring the reliability of the western bulk power system. We believe that neither of these options is workable, and that the Commission should therefore broaden application of price mitigation to all periods of time, not just to periods that fall within the 7 percent reserve margin criteria.

14. However, if the Commission elects not to broaden the scope of the conditions for price mitigation, the meaning of the reserve margin trigger must be clarified. At a minimum, the reserve criterion should reflect the actual operation of WSCC reserve requirements across the Western Interconnection, and perhaps should accommodate regional differences in generation stock and reserve sharing. However the criterion is determined, if a relationship is established between the incidence of reserve margin emergencies and unjust and unreasonable rates, the Commission should clarify that this condition is triggered by a reserve shortfall, however defined, anywhere in the WSCC, including the California ISO. That is, if the California ISO enters a reserve margin emergency, the mitigation strategy would be triggered for the entire WSCC. This is necessary under the logic that ties market dysfunction to reserve short-falls. When the WSCC is viewed as a single interconnected wholesale market, the incidence of a

supply shortage anywhere in that market will produce conditions for potential abuse of market power, and the resulting prices will influence prices throughout the WSCC.

**B. How Price Mitigation Should Apply**

15. We turn next to the form of price mitigation to be applied throughout the WSCC.

The Commission's Order states:

Any sales made in other real-time spot markets in the WSCC would also be subject to price mitigation and we seek comment on what this price mitigation should be. The WSCC price mitigation would be limited to system conditions when contingency reserves (as defined by the WSCC) for any control area fall below 7percent. The changes proposed herein for the WSCC are intended, to the extent possible, to mirror those being applied in Docket Nos. EL00-95-012, et al., as discussed above. Order at 30..

16. We agree with the Commission that, if price mitigation is applied in California, then it should be applied in some form throughout the WSCC. The California and broader WSCC markets are interconnected and factors affecting price in California--either market power in the California ISO or price mitigation measures established by the Commission--will affect prices throughout the WSCC. We also agree that the form of price mitigation throughout the remaining regions of the WSCC should mirror as closely as possible the mitigation applied in California. Market participants transact business throughout the WSCC, not just inside or outside California. Developing regulatory rules that are as clear and consistent as possible throughout the WSCC will minimize confusion and limit opportunities for arbitrage or other market power abuse.

17. However, it is clear that important features of the California market structure are not present throughout the wider WSCC. The California ISO is both a market location and a control area. In fact, the Commission's Order requires the California ISO to operate an auction-like market for real-time power purchases necessary for the ISO to meet load requirements. The

WSCC outside of California, on the other hand, does not contain discreet ISO's and does not function as a single location market that is coterminous with a control area. This does not mean that wholesale spot markets do not exist in the WSCC or that short-term, near real-time, transactions are not important. On the contrary, wholesale spot markets exist throughout the WSCC, and short-term transactions are very important for balancing individual utility and control area loads and resources. The difference between California and the rest of the WSCC is that all of these transactions in the WSCC are bilateral; they do not take place within a single-market and single-buyer structure. The full structure ordered by the Commission for California will not work more broadly throughout the WSCC.

18. However, important concepts in the Commission's treatment of California are transferable to a context of bilateral transactions. The calculation of a proxy price based on the highest heat rate generator and current or projected gas prices and environmental costs is a transferable concept. Similarly, the establishment of a "must-offer" requirement is an important tool to prevent strategic withholding of generation.<sup>4</sup> Exempting hydro-electric capacity from the "must-offer" requirement is transferable to the broader WSCC and particularly important in the Pacific Northwest, where river operations must abide by multiple-use statutory and regulatory requirements. Finally, broadening the scope of both the "must-offer" requirement and the price mitigation to all market participants through transmission access reciprocity and conditioning of market-based pricing authority is transferable and necessary to ensure that the market is treated comprehensively.

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<sup>4</sup>We interpret the Commission's proposal on page 36 of the Order to impose the "must-offer" requirement on all generators at *all* times, not just when the below 7 percent reserve margin is triggered. If this is not the Commission's proposal, further clarification is necessary. Clarification is also necessary about what a generator would need to show to carry the burden of proof that the must-offer requirement was met.

19. What is not transferable, however, is the single-price, market clearing auction for real-time (or day-ahead) California ISO purchases. WSCC price mitigation will require an approach that covers a market of bilateral transactions.

20. The time provided for filing these comments is short, and the opportunity to develop a comprehensive proposal that carries the value of consensus is limited. We trust that the investigation to be undertaken by the Commission, and the public hearing, will offer further opportunity to focus on the available options. Whatever approach is ultimately implemented must be simple, straightforward, and easy to understand. It must provide information about the rules and level of prices at which mitigation is to apply *before* transactions are made, not *after* the fact. We believe this is absolutely necessary to allow for informed market decisions and to ensure that the mitigation will serve to improve market stability.

21. At this point, we can describe in concept two options. Either approach could be implemented on an interim basis pending the final completion of the investigation. The first establishes a price mitigation ceiling at a level to be applied generally throughout the WSCC. At this early stage of the investigation, the WUTC favors this approach because it is the clearest and simplest to implement. The second approach establishes price mitigation constraints to be applied to individual market participants based on net-revenues or profits.

#### **1. Price Mitigation to be Applied Generally**

22. This approach builds on the concept of proxy marginal price, which the Commission has ordered for the California market. While this proxy cannot be implemented broadly in the WSCC as a “market clearing” price for all bilateral transactions, as it would in the California ISO, it nonetheless captures the market theory that prices should not rise above the operating costs of the least efficient generator.

23. To maintain consistency with what is proposed for California, the mitigation should apply to short-term (day-ahead or week-end pre-scheduled) transactions and, as we have argued above, should apply to all hours at all times, not just those triggered by a reserve short-fall somewhere in the WSCC.

24. The *level* of the price ceiling could be established in one of two ways. As one alternative, the clearing price in the California ISO market auction could be used. This has the benefit of being an already-calculated and accessible number that likely will reflect the highest proxy cost for generation in the WSCC. It also establishes a single level for price mitigation across the entire WSCC, rather than multiple levels that could lead to both confusion and arbitrage opportunities. It has the disadvantage, however, of tying the entire interconnection to a highly volatile situation in California and ignoring the possibility that generation costs outside California could well be lower because of less-severe constraints on natural gas delivery or environmental emissions (*i.e.*, lower emissions offset costs).

25. Alternatively, a proxy cost for a selected, least-efficient, natural gas fueled generator located in the WSCC outside of California could be calculated and posted, perhaps by the WSCC, on a day-ahead basis following the same basic proxy-cost formula the Commission has ordered for the California ISO auction. This approach has the benefit of avoiding circumstances like gas delivery constraints or environmental costs that are unique to California. It has the disadvantage, however, of potentially yielding price ceiling levels that differ from those in effect in California that could produce either confusion or arbitrage opportunities.

26. Either approach would yield a clear and posted level of price not to be exceeded in the WSCC for the short-term transactions covered by the price mitigation plan. Neither proxy

would be a simple, inflexible, price cap. Both would accommodate variations in fuel costs and other variable costs included in the proxy calculation.<sup>5</sup>

27. We see two options for *implementation* of a generally applicable price ceiling. The first is implementation through the Western Systems Power Pool agreement. We understand this to be a Master Agreement under which the bulk of wholesale power transactions occur across the WSCC. It should be possible to amend or modify this agreement to establish the ceiling price determined under either of the approaches described above.

28. Alternatively, the Commission could impose the mitigation price established for the WSCC as a blanket condition on all sales under approved market-based rate tariffs.

## **2. Price Mitigation Tailored Individually to Market Sellers**

29. Some have proposed a price mitigation approach that establishes a level of “profit allowance” for each seller of wholesale power in the WSCC. The profit allowance approach differs substantially both in concept and implementation complexity from the general price ceiling approach. It is argued to have a number of advantages, but also has a number of disadvantages. We include it here to provide the fullest range of possible approaches available for consideration by the Commission.

30. The profit allowance approach specifies an amount of fixed cost recovery that sellers would be allowed to collect in any given month. Hourly prices would not be capped or restrained in any way--buyers and sellers would be free to continue to negotiate mutually acceptable terms and conditions for sales of wholesale power, including price. Legitimate operating costs, such as fuel and operations and maintenance costs, could always be recovered.

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<sup>5</sup>Local circumstances could cause the legitimate costs of some generation to rise above the proxy costs. Transactions should be permitted to occur above the posted price ceiling, but only under conditions of subsequent review by the Commission and subject to refund.

However, profits realized by sellers above a specified amount in a month would be subject to refund.

31. Under this approach, the Commission would hold a proceeding to determine a formula for a profit allowance that would apply to all generating units in the West. The formula would contain a fixed amount of profits that could be earned for each kW of installed capacity, and a variable amount per kWh to encourage generators to run more hours. Sellers would submit monthly reports with operational data for each generating unit including hours of operation and operating costs, and data documenting all revenues received from sales of wholesale power or ancillary services under Commission-approved tariffs. Upon receipt of the monthly reports, Commission staff would calculate the monthly profit allowance using the Commission-approved formula and compare that to profits received above operating costs for each seller.

32. Sellers could choose to have the Commission apply the profit allowance associated with a proxy generation portfolio, or if actual operating costs were higher, to file those costs with the Commission for application to specific units. The profits that marketers could earn would also be limited by the proxy portfolio allowance. This would allow marketers to realize any profits that generation owners did not realize in their initial bulk power sales, but would not allow power “laundering” through third-party transactions.

33. Implementation could begin prior to formal Commission action adopting the approach. The Commission could immediately establish a mechanism to track amounts earned above a potential profit allowance. If the Commission later decided to adopt the proposal, the accounting for these amounts would already be in place and the Commission would need only to determine legitimate operating costs before ordering refunds to Western purchasers. If the

Commission decided not to adopt the proposal, these amounts could immediately be credited to company bottom lines.

34. The profit allowance approach is argued to offer the following advantages:
  - (1) Hourly and daily prices are allowed to vary with no constraints. This is important because variable price signals can encourage conservation or load shifting during times of critical shortage.
  - (2) The approach directly addresses the economic harm associated with the exercise of market power. It shifts the focus to whether the *average* price charged over a month is just and reasonable. Economic harm comes from the exercise of market power to extract monopoly rents over an extended period of time, rather than in an individual hour or day.
  - (3) The approach does not require an entity such as a control area or security coordinator to declare emergency events triggering price mitigation.
  - (4) Because the profit allowance is applied on a generator-specific basis, new generators could be exempted from the mitigation. For example, the mitigation might apply only to generators in place and producing power as of December 31, 2000.
35. The profit allowance approach also has disadvantages. Key among these are:
  - (1) The approach may be administratively burdensome. It requires a level of profit allowance, and the actual or proxy cost structure, to be established for each seller in the WSCC.

(2) The approach does not send clear and consistent general signals to the market. It focuses on the profit level for individual firms. Violation of mitigation levels is determined only “after the fact.”

## **V. CONCLUSION**

36. Wholesale prices for power in the WSCC are volatile, extraordinarily high, and disconnected from underlying costs. They also may be the consequence of the exercise of market power within and outside of California. The West-Wide 206 Investigation initiated by the Commission is both warranted and of critical importance to electricity consumers and the economies of Washington and other western states.

37. Because power prices have exceeded reasonable production cost levels during all hours and because the determination of a reserve-margin trigger in the WSCC outside California is difficult if not impossible, the Commission should broaden the scope of this investigation to include all power trades in the short-term market and not just those that occur under periods of reserve emergencies.

38. The Commission has available to it price mitigation mechanisms that are practical to apply across the WSCC and that have the potential to bring stability to western power markets in a time of great uncertainty and tight generation supply complicated by severe drought. We have described some of these options in concept and offered our opinion that a price mitigation ceiling applied generally throughout the WSCC is the clearest and simplest approach to implement. Also, we have requested certain clarifications of the Commission’s Order. Finally, we recommend that examination of any of the approaches to WSCC-wide price mitigation could benefit from a technical conference as part of the investigation process.

39. We look forward to participating actively in further proceedings as a part of the Commission's investigation.

DATED this 4th day of May, 2001.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MARILYN SHOWALTER, Chairwoman

RICHARD HEMSTAD, Commissioner